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SIPDIS

DEPARTMENT OF ENERGY FOR PRICE/PI AND SALERNO/PI

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TAGS: ECON ENRG EINV EPET KZ ECONOMIC
SUBJECT: KAZAKHSTAN: INFORMATION REQUEST ON BARRIERS TO INVESTMENT

REF: State 189760

¶1. The following information is provided in response to Reftel questions.

Question 1(A)

¶2. By law, U.S. companies can purchase local oil companies. The January 2003 Law on Investments provides the legal framework for foreign investment in Kazakhstan, and does not differentiate between the rights of domestic and foreign investors. However, a December 2004 law gives the State a preemptive right to purchase shares in new and existing hydrocarbon projects. An October 2005 law extends the State's preemptive right to parent companies of entities holding subsurface rights in Kazakhstan.

¶3. U.S. companies can also obtain equity oil. However, a 2005 law stipulates that the state-owned oil and gas company (KazMunayGaz, or KMG) has the right to own a 50% interest in new Production Sharing Agreements. The December 2004 law referenced above also applies to the sale of consortia shares.

¶4. By law, a U.S. company can invest in the refining and petrochemical industries. However, the Kazakhstan Law on National Security was amended in October 2005 to grant the government the authority to restrict the assignment of a property right in "strategic resources" of the country. Existing refineries are likely to be considered "strategic resources."

¶5. By law, a U.S. company may market petroleum products.

Question 1(B)

¶6. Post is not aware of examples of U.S. companies attempting to purchase local oil companies. The more common forms of U.S. entry into the market are as a consortium shareholder, or by applying to the appropriate body (currently the Ministry of Energy and Mineral Resources) to obtain a contract for subsurface use (exploration and/or production).

¶7. U.S. companies participate in all three of Kazakhstan's large exploration and production consortia: Chevron is a 20% partner in Karachaganak KPO; Chevron is a 50% partner, and ExxonMobil a 25% partner, in Tengizchevroil; and ExxonMobil is a 18.52% partner, and ConocoPhillips a 9.26% partner, in AGIP KCO.

¶8. Post can provide few specific examples of U.S. company involvement in Kazakhstan's petrochemical industry, which is not well-developed. (To date, Kazakhstan's distance from markets for petrochemical products has discouraged outside investments.) Chevron, as a member of both the Tengizchevroil joint venture and the Karachaganak consortium, produces limited quantities of propane and butane for export.

¶9. The Kazakhstani government has made development of a petrochemical industry a priority. The 2005 Production Sharing Agreement law specifies that the "determining criterion" in the choice of future tender winners will be the bidder's commitment to introduce "high technology" to Kazakhstan, of which "petrochemical and further processing production" is rated as the first priority. The GOK recently chose Nexant, a U.S. company, to research prospects for developing Kazakhstan's petrochemical industry and to present recommendations on how to attract foreign investments.

¶10. ExxonMobil markets gasoline and diesel at a number of branded service stations. Chevron owned five service stations in Almaty until September 2005, when they sold the stations to state-owned KMG.

Question 2

¶11. As noted, Kazakhstan's Law on Investments provides

equal rights to both domestic and foreign investors. Thus, U.S. companies are not subject to any particular regulatory barriers or obstacles not faced by all investors.

¶12. Subsurface users are required to conclude individual contracts with the government. The commercial terms (royalties, taxes, etc.) differ according to the type of contract, with Kazakhstani law differentiating between a tax-royalty subsurface use contract ("Model 1" below), and a Production Sharing Agreement ("Model 2" below). Details of the commercial terms of both types of contract are available on-line from the major U.S. accounting firms doing business in Kazakhstan. However, the following chart outlines the general applicability of royalties and taxes to the two model contracts:

Applicable Taxes	Model 1	Model 2
¶A. Special taxes & payments of subsurface user		
Bonuses	Yes	Yes
Royalty	Yes	No
Excess Profit Tax	Yes	No
Share of the production	No	Yes
Additional payment under PSA "Top Up Tax" [the additional payment to the state budget to ensure that the total state's take will be 10% prior to the project's pay-back and 40% in the periods thereafter]	No	Yes
¶B. Other taxes & obligatory payments to the budget		
Rent tax on export of crude oil & gas condensate	Yes	No
Excise on crude oil & gas condensate	Yes	No
Land tax	Yes	No
Property tax	Yes	No
Environmental fees	Yes	Yes
Other fees (e.g. fee for use of navigable waterways, radio frequency spectrum)	Yes	Yes
Other taxes & payments	Yes	Yes

Source: Ernst & Young, Kazakhstan

¶13. A few aspects of the Kazakhstani subsurface regulatory environment deserve special mention. First, according to "local content" regulations, subsurface users in Kazakhstan are obligated to purchase goods (work and services) from Kazakhstan entities -- provided that the local goods meet minimum project standards -- and to give preference to the employment of local personnel. Prospective subsurface users are required to specify in their tenders the anticipated local content of their work, goods, and services. The 2004 Subsoil amendments also require that tender proposals specify the user's commitment to infrastructure projects and the economic and social development of the relevant regions of the country.

¶14. Kazakhstan's legal framework governing gas utilization and flaring is in transition. Gas flaring was prohibited altogether by 2004 law, except in emergency cases. October 2005 amendments mitigate these provisions, providing for a transition period up to July 1, 2006 for subsurface users to draft and present to the government authorities a program for gas utilization.

Question 3

¶15. Post does not have data on U.S. FDI to Kazakhstan's oil and gas sector. The data below, from the National Bank of Kazakhstan, show overall U.S. FDI to Kazakhstan from 1993-2005 and overall (all sources) FDI to Kazakhstan's oil and gas sector for the same period.

U.S. FDI in Kazakhstan in 1993-2005

1993 - $966.9 million
1994 - $412.0 million
1995 - $153.3 million
1996 - $164.2 million
1997 - $208.1 million
1998 - $399.8 million
1999 - $905.8 million
2000 - $951.2 million
2001 - $1460.4 million
2002 - $1011.3 million
2003 - $1105.5 million
2004 - $2970.6 million
2005, 1st Half - $412.6 million

Overall FDI to oil and gas sector in Kazakhstan in 1993-2005

1993 – $921.5 million
1994 – $410.1 million
1995 – $191.8 million
1996 – $257.7 million
1997 – $640.5 million
1998 – $506.7 million
1999 – $1372.5 million
2000 – $2002.1 million
2001 – $3059.5 million
2002 – $2070.8 million
2003 – $2113.6 million
2004 – $5200.5 million
2005, 1st Half – $761.3 million
Ordway